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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

RICHARD RUSSELL
P. O. Box 15196
San Diego 15, California

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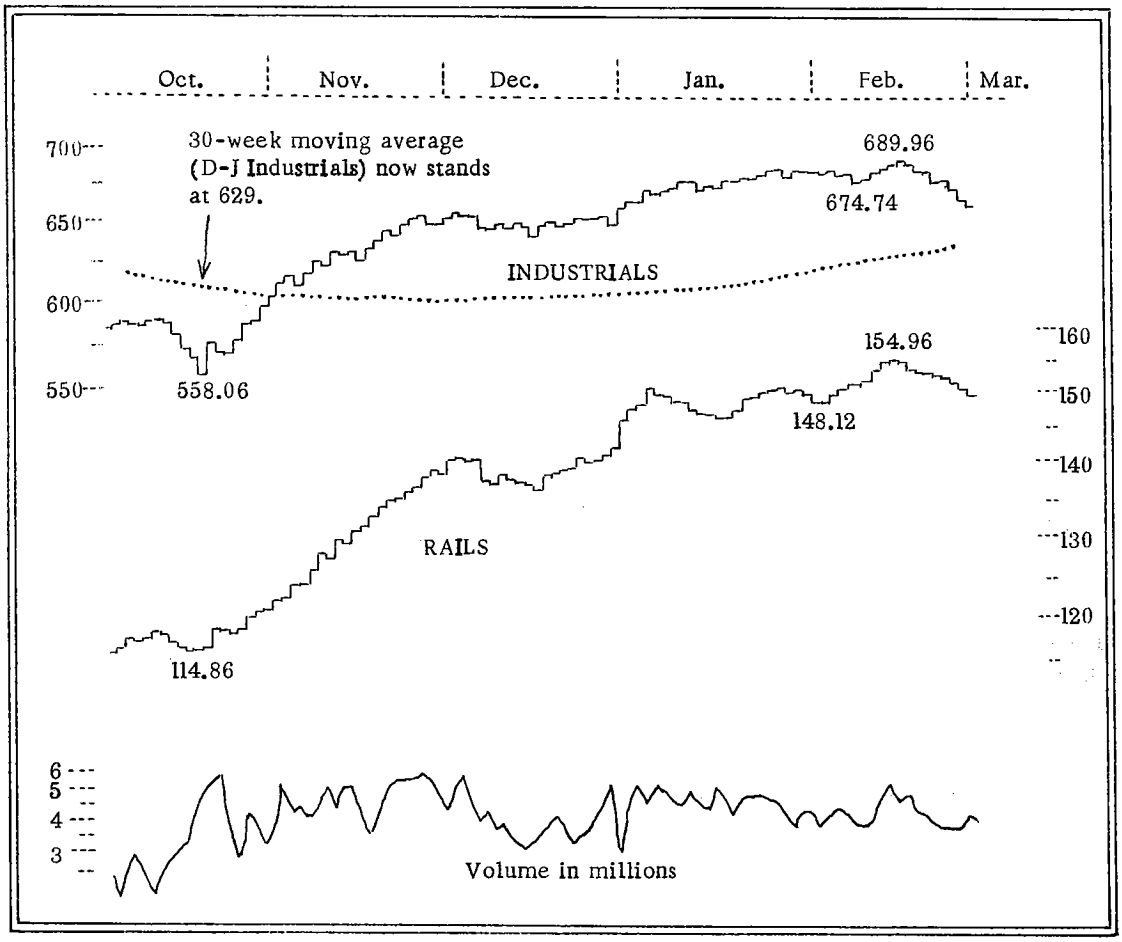
THE MARKET On February 15 Rails recorded a recovery high of 154.96. One day later Industrials rallied to touch a recovery high of 689.96. Volume contracted noticeably as the highs were struck. Following the peaks, both indicators turned down, and on February 25 Industrials retreated below their preceding low of 674.61. This decline took the senior Average back to the levels of early January. Bulls were quick to point to the light volume on the decline and the fact that Rails have (so far) refused to penetrate their comparable decline low of 148.12.

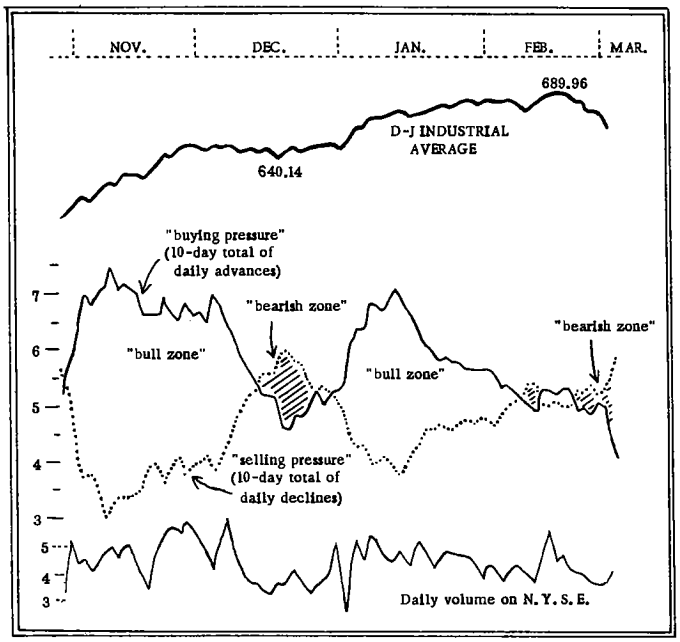
Nevertheless, as discussed over and over in recent Letters, the character of the advance since December has been unsatisfactory. Industrials have broken trendline after trendline (see Letter 209), Rails violated their main trendline in January (see Letter 207), and the market has been unable to gather upward momentum since mid-January. Moreover, individual stocks have not acted well, and I have commented repeatedly regarding the inability of stocks to "move out", once they have broken out of their chart patterns. Finally, two recent studies, (1) "The Short-Interest Ratio" in Letter 209, and (2) "Timing the A-D ratio" in Letter 210 both suggested that from the standpoint of time, there was a good chance that the majority of issues had seen their highs.

Subscribers are asking: "Will this be a decline, a severe reaction or a resumption of the major bear market?" I wish I knew the answer. There are plenty of crystal-ball gazers around who are only too eager to announce that the Industrials "will stop" at such and such a level, but market students prefer to use "check points" or preceding levels to guide them. Joint penetration by the two Averages above or below preceding points provides a useful gauge of increasing or decreasing demand for equities. If volume expands on a joint penetration, the authority of such a movement is increased.



Since December, upward penetrations by the Averages have been followed by rather unconvincing rallies, subsequent "out-of-gear" movements and general "confusion". Since mid-February (at which time the two Averages recorded their recovery peaks)

the downside action has been rather convincing. For instance, on February 28 volume rose to 4.09 million as the market declined, and new lows rose to 11 (highest number since November 1). As of this writing, however, Rails have not penetrated their 148.12 level of February 5. As long as Rails can hold above that point (see chart) the bull case has not completely evaporated.



BUYING AND SELLING PRESSURE (a continuation of last week's study): Since early February (see chart) the buying and selling lines have been crossing and recrossing with neither line assuming any particular momentum. On the last day of February, however, the selling line broke out of its area and rose to its highest level since mid-December while the buying line also broke below its recent area and dropped to the lowest level since October.

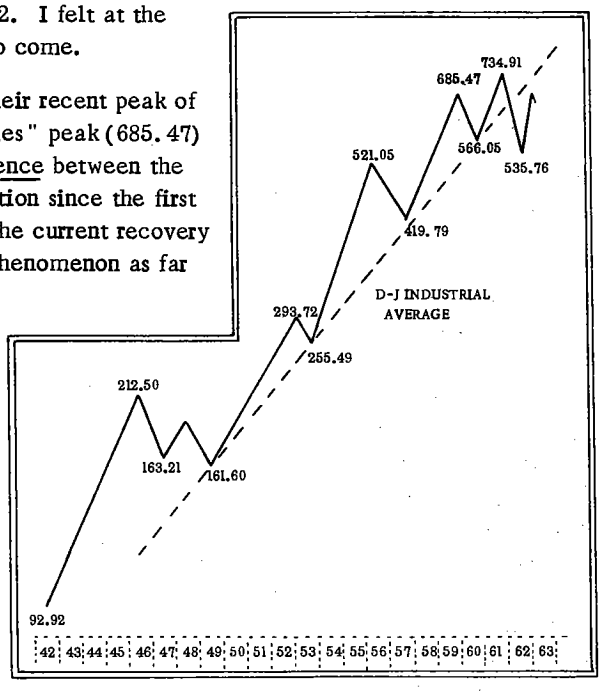
I have included daily Exchange volume at the bottom of this chart. With the addition of volume, it becomes apparent that activity "dried up" in mid-December -- as selling pressure assumed the dominant position. Then during January as buying increased, volume tended to expand. Towards late-January the Industrial Average pushed higher. But here the chart shows that despite the rising Industrial Average, buying pressure was declining and volume was diminishing.

The picture is now particularly interesting. Normally, when two large "buying areas" have occurred (as has been the case), a full (downward) correction is the expectation. The rising selling line and the falling buying line suggest the possibility of a full correction. So far, as seen on the chart, buying pressure has dropped sharply, but selling has not been quite as insistent. Important selling will be recognized when (or if) the selling pressure line rises into the 6.5 to 7 thousand decline level on the graph (this would signify that over a 10-day period, 6,500 to 7,000 issues declined).

UNDER THE TRENDLINE The accompanying chart traces the major swings in the D-J Industrials from 1942 to the present. The chart is drawn to semi-logarithmic scale so that all movements are shown in percentages of advance or decline. Thus, the 1942-46 bull market took Industrials from 92.92 to 212.50, hardly a record-breaker in terms of points gained. But as seen in terms of percentages, the 1942-46 rise was impressive and profitable.

The great advance which began in June, 1949, traveled along a single trendline for twelve years (see chart). In other words, from 1949 to 1961 the Industrials were able to hold (during all advances and reactions) to a continuing rate of upward thrust.

As seen on the chart, the great twelve-year trendline was shattered in 1962. I felt at the time (and still do) that this was the market's way of warning us of things to come.

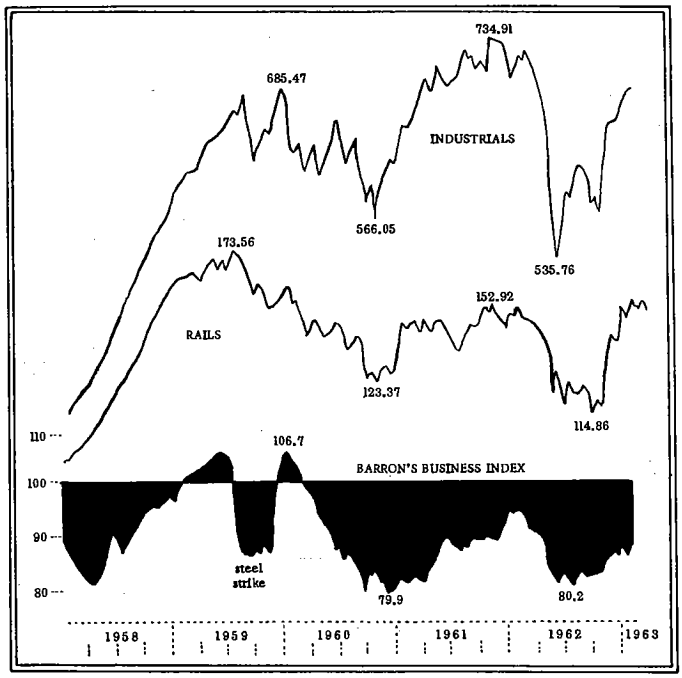


Since June, 1962, the Industrials have staged a violent recovery, and at their recent peak of 689.96 (February 18), they exceeded by 4 points the famous "Soaring Sixties" peak (685.47) recorded in January, 1960. But the chart dramatically points up the difference between the 1962-63 advance and all previous advances -- the difference is that all action since the first quarter of 1962 has taken place below the great 1949-61 trendline. Thus the current recovery has taken the form of a "pull-back" (to the trendline), a not uncommon phenomenon as far as technical analysis is concerned.

Based on past history, the odds for the Industrial Average's moving above the old trendline again are exceedingly slim. By the same token, I feel that the next year or so may well see a larger correction of the 1949-61 rise than was seen during 1962.

COMMENTS AND COMPARISONS "The completely unprecedented performance of the market during the spring months of April, May and June, 1962," writes James Hughes of New York, "is emphasized by the fact that it occurred during a period of expanding banking and industrial production. However, in view of these same trends, the April-May-June decline in the stock market must go down in history as a super-economic anachronism."

In other words this well-known analyst is saying that in view of recent banking and economic trends, the 1962 collapse never should have occurred. All this may be true, but it is well to remember that the market discounts everything -- political, social, and economic -- which is capable of affecting forthcoming corporate profits. It occurs to this writer that the 1962 collapse may have been discounting political and social (as well as economic) shifts which even now are not fully understood.



A tabulation shows that although the Industrial Average has climbed to within 8% of its all-time high, only 7% of the listed Industrial and Rail stocks have succeeded in coming within 8% of their 1956-61 peaks. Thus (as many stockholders know), a great majority of issues are still well below whatever bull market peaks they have recorded in the last five or six years. This laggard performance by the great majority of stocks suggests that things may not be as "rosy" as Fortune Magazine currently thinks they are. The listless performance may also account for the remarkable apathy shown by the public during the current rise.

Despite the mounting hopes of many investors, the national picture has simply refused to "glow" as many expected it would. The following paragraph from economist Eliot Janeway's weekly report lists some of the more pressing problems: "Today, there are rumors of a Russian build-up in Cuba. There is concern over the dwindling chance of a tax cut in this session of Congress. The stock market rally is stuttering. Leading indicators are pointing to the stubborn sag and drag in the economy. There is a surprising failure of Government programs to come to grips with economic problems. And the considerable Federal deficit, plus the increase in spending associated with it, are contributing no lift to the economy."

I last published a chart of Barron's Business Index and the Averages in Letter 204 (December 20, 1962). At that time I noted that Barron's Index had risen from a low of 80.2 in July, 1962, to a high of 86.3 in December, 1962. This represented a 7% expansion for Barron's Index five months after that Index had recorded its bear market (or recession) low. Letter 204 made the following comment: "A 7% rise in the Index five months from the low constitutes a sluggish recovery. In fact, in the face of (1) at least a temporary market bottom and turn-up in Barron's Index, and (2) a violent market rise, it is one of the poorest Business Index performances of the last decade."

In view of the further market recovery since Letter 204, I feel it is worthwhile to review this study again. The Industrial Average was in the 650 area when Letter 204 was written. Subsequently, the Average climbed another 35 points. Yet, as of last week, Barron's Business Index read 87.3. This means that American industry (particularly "heavy" or cyclical industry -- the type measured by Barron's Index) has done little or nothing since December's dull recovery.

The dramatic sluggishness in the economy brings up a number of interesting questions: (1) Is this the reason why so many issues have not been able to keep up with leading Dow stocks on the recovery? (2) Is this the reason why the low-priced stocks (which need a business "boom" in order to register dramatic profits) have lagged so badly behind the general market? (3) Has the market rise been predicated mainly on fears of inflation and "monetary arson" via Mr. Heller, President Kennedy and the new Frontiersmen?

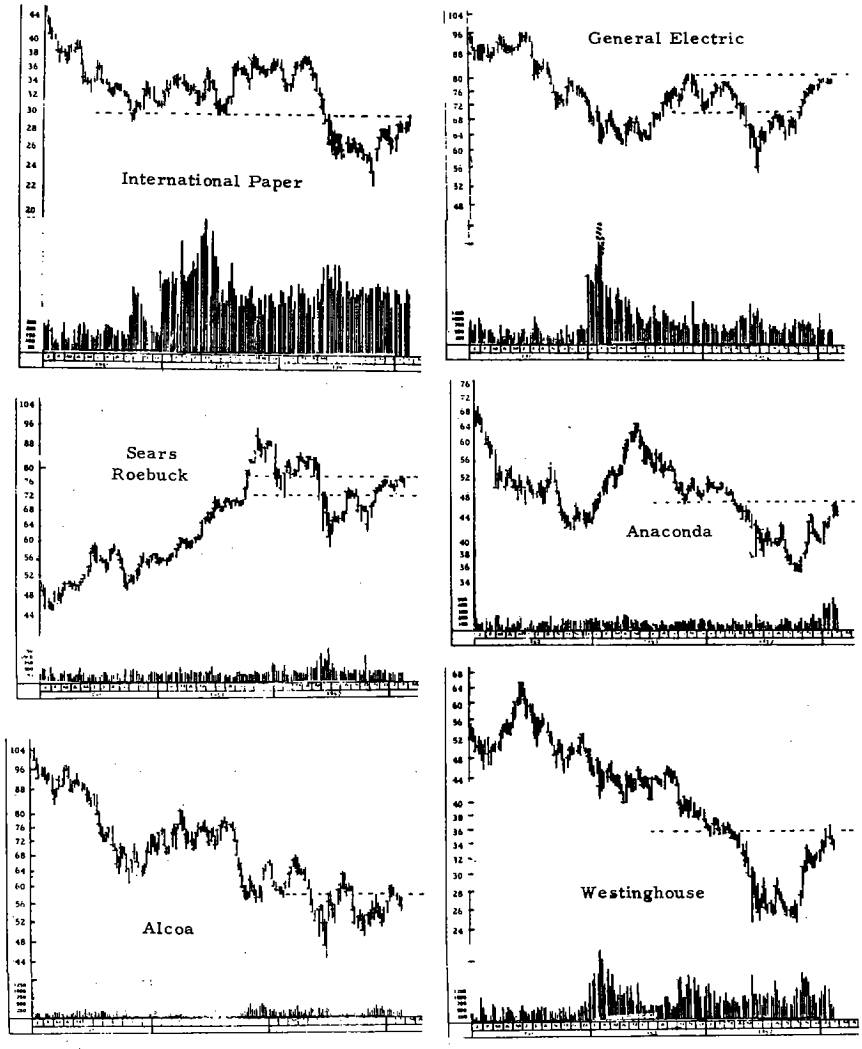
If the latter is true, then stocks have risen for the most tenuous of reasons -- the fear of inflation (rather than the discounting of expanding earnings). In all fairness, however, it must be added that President Kennedy is trying his best to add fuel to the monetary fires, and he is rapidly assuming the place of honor as "greatest inflationist of the Century". The last Letter ventured to predict that our President would not hesitate to scrap "tax reforms" and then push for any kind of a whopping tax cut. A day later he did just that.

LATE NOTES (Written Monday, March 4, 1 P.M., N.Y. time): Last week was one of those rare weeks in which over 1000 issues either advanced or declined. As it happened, 1043 stocks declined while only 317 stocks advanced last week. Such momentum is not to be taken lightly. The usual action following an "over 1000 week" is that a reversal occurs during the next week -- followed by further substantial movement in the direction of the movement which produced that 1000 advances or declines. If this sequence occurs, we can expect a rally this week, followed by renewed selling. I would use any rallies in this area to reduce trading and investment accounts. (As this is written, the Rails have jumped over 4 points on news of a favorable Supreme Court decision regarding "feather-bedding", and Industrials have rallied over 6 points. It will be interesting

to see whether volume can expand significantly with upside action).

STOCKS Of 350 representative stocks which are tabulated here each week, 225 (64%) are now holding above their 30-week moving average (a drop of 12% from last week). Of the same stocks, 157 (45%) are now above their late 1962 recovery high (a large drop of 17% from last week).

Although the 1962-63 rise succeeded in recovering 77% of the 1962 crash-losses in the Industrial Average, it is a remarkable fact that on the recovery only two Dow stocks (General Motors and Standard of California) rose to new all-time highs. In the case of the majority of Dow stocks, the recoveries stopped in the areas of previous "trouble", and this is typical of bear market action.



I have included six (random) charts of Dow stocks. They are typical of most stocks at this time. The dotted line (or lines) delineates preceding major areas of supply (known as "resistance" areas). In general, the greater the volume at a preceding resistance area, the stronger the resistance offered when that area is again approached from below. A resistance area is simply a level at which stockholders are "locked in" with their mistakes. As these levels are again approached, many of the saddened stockholders are ready to "bail out" and take cash for their stocks. This creates a certain amount of stock for sale at the old levels. The greater the number of "locked-in stockholders" (or the greater the volume that appeared at the old levels) the greater the potential selling when those levels are again approached from below.

Note that Int. Paper stopped exactly at its 1960-61 lows. Gen. Electric "lost steam" in the area at which it "topped out" in 1961-62. Sears turned down around its 1961-62 bottom. Anaconda stalled exactly at its 1961-62 bottom. Alcoa rose into its 1962 supply but never got far. Westinghouse just touched its 1961-62 supply -- then turned down.

In true bull swings, stocks plow through their previous "supply" areas as if such areas never existed. This has not been the case during 1963. For instance, General Motor's old high was 58, Standard of California's old high was 62. Even though these highs were bettered in 1963, these two stocks have not moved out impressively above the old highs. And their action has been supurb compared to the rest of the market.

Charts on this page courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri.